



Department of Health Care Services  
**MEMORANDUM**

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Date: December 21, 2007

To: Bryan Hobson, Chief  
Program Support Branch  
Administration  
1501 Capitol Avenue, MS 1400

From: Thomas J. Rakela, C.F.E., Chief  
Internal Audits  
1500 Capitol Avenue, MS 2001  
(916) 445-0759

Subject: Contract Exemption Review Final Report (07517)

Internal Audits has completed the Contract Exemption Review of the former California Department of Health Services (CDHS).

CDHS separated into two distinct departments, the Department of Health Care Services (DHCS) and the California Department of Public Health (CDPH), as of July 1, 2007. The results of this report pertain to Exemption Letter 55.3 which was granted to the CDHS.

A new Exemption for the DHCS was approved by the Department of General Services (DGS) on August 31, 2007, and covers the period October 1, 2007 through September 30, 2011. The audit for this Exemption is due September 30, 2009.

Attached is a copy of the final report. This audit was performed to comply with the DGS' Exemption Letter 55.3 and its amendments. This Exemption Letter allowed the CDHS and will allow the DHCS to execute contracts under \$75,000 without first obtaining DGS approval.

If you have any questions, please call me at 650-0272.

Attachment

cc: See next page

Bryan Hobson  
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cc: Karen Johnson  
Chief Deputy Director  
Policy and Program Support  
Department of Health Care Services  
1501 Capitol Avenue, MS 0003

John Eastman  
Deputy Director  
Administration  
1501 Capitol Avenue, MS 1000

Joie Michael Silva, Chief  
Administration Section  
Information Technology Services Division  
1615 Capitol Avenue, MS 6304

Robert O'Neill, Chief  
Office of HIPAA Compliance  
1501 Capitol Avenue, MS 4721

Richard Gillam, Chief  
Office of Audit Services  
Department of General Services  
707 Third Street, Eighth Floor

Fred Daniels  
Audit Supervisor  
Office of Audit Services  
Department of General Services  
707 Third Street, Eighth Floor

**DEPARTMENT OF HEALTH CARE SERVICES  
INTERNAL AUDITS**

**CONTRACT EXEMPTION REVIEW**

**DECEMBER 2007**

**AUDITOR:  
MARY CODY, C.P.A.**

**THOMAS J. RAKELA, C.F.E.  
CHIEF OF INTERNAL AUDITS**

**ASSIGNMENT NO. 07517**

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# EXECUTIVE SUMMARY

## EXECUTIVE SUMMARY

Internal Audits has completed its review of the California Department of Health Services' (CDHS or Department) internal controls for the processing of specific contracts. This review is required by the Department of General Services (DGS) in their Exemption Letter 55.3 and its amendment. The exemption allows CDHS to let contracts under \$75,000 without obtaining DGS approval. Our review concentrated in the Department's Contract Management Unit (CMU), applicable programs, and Accounting. The review included testing of contracts, grants, Service Orders (SO), the Department's CAL Card usage, and contractual agreements written under the Master Service Agreements (MSA) and the California Multiple Award Schedules (CMAS).

CDHS separated into two distinct departments, the Department of Health Care Services (DHCS) and the California Department of Public Health (CDPH), as of July 1, 2007. The results of this report pertain to Exemption Letter 55.3, which was granted to the CDHS.

The audit report opinion is qualified because contracts are not consistently approved on time (repeat finding).

This report contains a total of three audit findings:

- More than 75 percent of the 30 sampled contracts processed and approved were finalized after the contract period. Some of the contracts did not contain an explanation for being late.
- Contracts for moving services did not contain prevailing wages provision.

Since part of this review was to examine the Department's contractual agreements written under CMAS, we included one additional finding from the Department's State Administrative Manual (SAM) 20000 review (Assignment # 07515).

- The Office of HIPAA Compliance did not provide requirements for HIPAA Compliance to a CMAS vendor and did not determine if there was a conflict of interest as required in the CMAS contract standard language.

The findings and recommendations were discussed with CMU and applicable program management during the course of our audit. CMU and program management were very receptive to our findings and corrective action was underway on several of the findings.

## AUDITOR'S OPINION

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Internal Audits has conducted a review and evaluation of the system of internal controls for the processing of contracts by the California Department of Health Services' (CDHS or Department) Administration Division in effect as of September 30, 2007. Our examination was conducted in accordance with the auditing standards published by the Institute of Internal Auditors, Inc. Compliance testing was performed in accordance with the approved Department of General Services (DGS) Audit Guide and requirements found in the State Administrative Manual (SAM) Chapter 1200, and the State Contracting Manual.

The examination included a review to document the system of internal controls for the processing of contracts, to determine if the system of internal controls can be reasonably relied upon, and to test the effectiveness of the internal control system through evaluation of a sample of contracts awarded since the last internal audit.

A sample of contracts was selected for review from each of the following categories as required by the DGS Audit Guide:

- Contracts under \$75,000 as specified in DGS Exemption Letter 55.3 and its amendment.
- Contracts including grants exempted from DGS approval by statute, an Attorney General's opinion, or other authority
- Informal contracts, such as Service Orders.
- Contracts and Services Orders written under the Master Service Agreements.

Contract agreements were selected randomly and judgmentally to ensure that a comprehensive variety of contractual agreements were examined for this review. In part, Internal Audits reviewed the contracts to ensure whether:

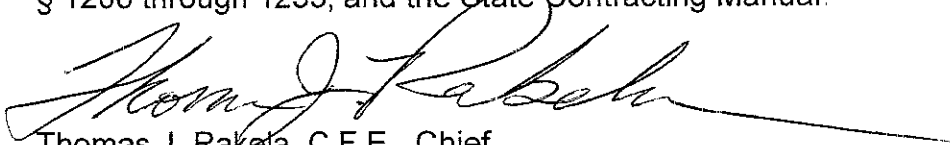
- Acceptable policy and procedures and adequate separation duties existed.
- Contracts were approved timely.
- The scope of work was clear and payment terms appropriate.
- Services were started after the contract was approved.
- Appropriate components were included in the contracts.
- Résumés were included when appropriate.
- Grants should have been contracts.
- Contracts were properly and adequately monitored, including post evaluations.
- Contracts were not split to avoid approval of DGS.
- Payments were made timely.
- Amendments properly processed through DGS when the amount was over \$75,000



Nothing came to our attention during this review to indicate that any contracts were inappropriately classified as grants.

Our review and evaluation disclosed that the current control system could not ensure that contracts were approved prior to commencement of the contract period and prior to the commencement of contract work.

In our opinion, except for the condition described in the preceding paragraph, the system of processing contracts by CDHS' Administration Division, in effect as of September 30, 2007, taken as a whole, is adequate and sufficient to provide reasonable assurance that contracts are in compliance with the State Administrative Manual, § 1200 through 1233, and the State Contracting Manual.

A handwritten signature in black ink, appearing to read "Thomas J. Rakela", with a long horizontal flourish extending to the right.

Thomas J. Rakela, C.F.E., Chief  
Internal Audits

## BACKGROUND

## **BACKGROUND**

The Department of General Services (DGS) has been designated by the State Legislature as the lead agency to oversee state contracts. However, the Director of DGS has the authority to exempt certain contract transactions from the legally required DGS approval. The law that established DGS' authority also sets the maximum dollar amount of the exemption, \$75,000 beginning January 1, 1995, for the letting of contracts and sets specific requirements that must be met. An audit of the Department's contracting process is one of those requirements. CDHS is granted an exemption only after a quality control review of this audit is done by DGS to assure that the requirements for exemption were met.

The purpose of this audit is to determine compliance with the conditions of the Exemption Letter 55.3 and its amendment, which include compliance with specific legal requirements. To that end, the DGS Audit Guide was used to conduct this audit. DGS can then conduct a quality control review economically and efficiently.

# FINDINGS AND RECOMMENDATIONS

## FINDINGS AND RECOMMENDATIONS

**Finding 1** The vast majority of 30 sampled contracts processed and approved were finalized after the start of the contract period. Some of the contracts did not contain an explanation for being late. Work was started prior to a contract approval.

**Condition** The review found that more than 75 percent of the 30 contracts sampled were approved after the start of the contract period. Some contracts were approved as late as nine months into the contract period. Several contracts did not contain an explanation for being late. Furthermore, services were performed prior to the contract being approved.

According to the Contract Management Unit (CMU), they encourage Department staff to submit contract packages timely. Due to various reasons, CDPH staff continues to submit contracts late or incomplete causing delays in approving contracts. However, one major reason for the late contracts is chronic delays in passing the state's budget.

Contractors commencing work before an agreement is fully executed run the risk of having the agreement disapproved or payments disallowed or delayed. This, in turn, could cause problems for the programs in achieving their delivery of services. Regardless, CMU has no control over when services are performed. This issue is addressed by the specific program.

**Criteria** CMU is required to process contracts in an efficient and timely manner. HAM, § 9-2110 states that contract approval can take between 2 and 14 weeks or longer from the date a final contract package is received by CMU for processing before the agreement is fully executed.

The State Contracting Manual (SCM), § 4.02 states that each state agency is responsible for making sure that its contracts comply with applicable legal requirements and is based on sound business practices. CMU should make every effort to process and approve contracts timely.

SCM, § 4.09 states that the basic state policy is that no contractor should start work until receiving a copy of the formally approved contract. Contractors that begin work before an agreement is fully executed face the risk of having the agreement disapproved or payments disallowed or seriously delayed.

**Recommendation A** CMU and programs should make every effort to comply with regulations to ensure that contracts are processed timely

**Finding 2** A contract for moving services did not contain a prevailing wage provision. Additionally, the contractor provided services prior to the contract being approved.

**Condition** A contract for moving services (05-46249) did not contain provisions that required the movers and supporting personnel to operate under current collective bargaining agreements or to maintain the prevailing wages, standards, and conditions of employment for its drivers and supporting personnel. It is particularly important that CDPH comply with these requirements in anticipation of the intended moving schedule for the next several years. Also, it is important to comply with the SCM and related regulations pertaining to wages to avoid any potential labor issues.

Additionally, contractors began work before the agreement was fully executed. The contract was approved August 16, 2006, for the term of July 3, 2006 through September 23, 2006. A billing invoice dated August 2, 2006, shows that services were provided on July 21, 2006, prior to the contract approval. Contractors that proceed with work before the contract is approved face the risk of having the agreement disapproved and payments disallowed or seriously delayed.

The CDHS employee familiar with the contract is no longer the contract manager. However, the current employee stated that every effort will be made to include prevailing wage provisions in contracts and schedule moving events after the contract is approved.

**Criteria** SCM, § 3.25 states that contracts exceeding \$2,500 with a carrier for commercial office moving services must conform to requirements contained in SAM, § 3810, which provides for such contracts to be with a carrier whose drivers and supporting personnel are operating under current collective bargaining agreements or who are maintaining the prevailing wages, standards, and conditions of employment for its driver and supporting personnel.

SCM, § 4.09 states that no contractor should start work until receiving a copy of the formally approved contract.

**Recommendations B** Staff should include prevailing wage provisions in all moving contracts.

**C** Staff should not allow contractors to commence performing services until the contract is fully executed.

**Finding 3**     The Office of HIPAA Compliance did not provide requirements for HIPAA Compliance to CMAS vendors and did not determine if there was a conflict of interest as required in the CMAS contract standard language.

**Condition**     A review of the California Multiple Award Schedule (CMAS) contracts revealed that in contracts with Trinity Government Systems and R Systems, the Office of HIPAA Compliance (OHC) did not follow the service requirements in the CMAS standard language. The standard language directs the Department to provide written identification of items that are confidential data and the State's procedural requirements for the protection of such data. The OHC stated that they were unaware of the requirements. As a result, the OHC has placed the Department at risk of a conflict of interest and a breach of HIPAA compliance.

**Criteria**     Information Technology Terms and Condition, General Provisions, No. 34 states that the identification of all such confidential data and information as well as the State's procedural requirements for protection for such data and information from unauthorized use and disclosure shall be provided by the State in writing to the contractor.

CMAS, No. 3-02-70-1257D, Supplement, Conflict of Interest states that agencies must evaluate the proposed purchase order to determine if there are any potential conflict of interest issues.

**Recommendations**     **D**     Develop procedures to systematically notify all active service CMAS contractors and other service contractors in writing of the State's requirement to protect Personal Confidential Information and Personal Health Information data from unauthorized use and disclosure.

**E**     OHC should determine if there is a conflict of interest with all CMAS vendors.

**AUDITEE'S RESPONSE**



## **Responses to the Contract Exemption Review CDHS Exemption Letter 55.3**

The findings in this report are also found in the contract section of our Review of the Department's Administrative and Accounting Controls for December 2007

Since the findings and recommendations are the same in both reports, the responses below were taken from the report of the Review of the Department's Administrative and Accounting Controls for December 2007. The finding numbers were changed to reflect the numbering sequence for this report.

### **ADMINISTRATION DIVISION RESPONSE**

**Finding 1     The vast majority of 30 sampled contracts processed and approved were finalized after the start of the contract period. Some of the contracts did not contain an explanation for being late. Work was started prior to a contract approval.**

**Response**     CMU concurs with the audit finding. This is a historical audit finding for DHCS programs. Although a number of efforts have been undertaken over the past couple of years, the timely processing of all contracts is a goal that has yet to be attained.

The Department of General Services (DGS) issued Administrative Order 06-05 on April 17, 2006 and Administrative Order 06-05.1 on June 20, 2006 announcing DGS' policy and requirements for approval/non-approval and acceptance requirements, and exceptions for submitting untimely contract documents to DGS for approval. CMU model instructions have historically required a late reason to be entered on the Agreement Summary if a finalized agreement arrives in CMU in less than 4 weeks prior to the contract start date and will reemphasize that requirement to program staff.

In response to Administrative Order (AO) 06-05.1 mandating that most contracts be submitted for DGS' review in a timely manner, DHCS programs have processed an increased number of contracts in a timely manner. CMU staff has also experienced a marked increase in the number of procurements that were initiated early in the calendar year with the goal of executing timely contracts. For those agreement types that do not meet a timeliness exception identified by DGS in AO 06-05.1, Program staff will be required to either modify the contract start date or certify their rationale for untimely submittal through a certification approval process outlined in AO 06-05.1.

In an effort to stimulate timely contract initiation, CMU will continue to issue its annual bulletin reminding Programs to process their contracts in a timely manner and to discourage contractors from beginning work prior to receiving a copy of a fully approved and executed contract. CMU will also continue to maintain model letters and bid documents warning contractors not to begin work in advance of being notified that all contract approvals were obtained.

It should be noted that the physical separation and relocation of CMU's contract files and file room contents, which came about because of the departmental reorganization, will likely result in a many late contracts since many files were inaccessible and/or misplaced before and during our physical move and office re-establishment.

**Finding 2**     **A contract for moving services did not contain a prevailing wage provision. Additionally, the contractor provided services prior to the contract being approved.**

**Response**     This was a one-time only contract that required PSB to relocate three separate programs or organizations within the DHS within a limited period of time. PSB could not cancel or delay this relocation as it was important to remain on schedule for the opening of the DHS' Emergency Operations Center. The PSB is looking at implementing provisions or methods to ensure that this does not occur again. The PSB agrees that the prevailing wage provision was not included in the contract. This was an oversight that the PSB will take steps to ensure that it will not occur again.

## **OFFICE OF HIPAA COMPLIANCE RESPONSE**

**Finding 3**     **"The Office of HIPAA Compliance did not provide requirements for HIPAA Compliance to CMAS vendors and did not determine if there was a conflict of interest as required in the CMAS contract standard language."**

The report included two recommendations for this finding.

**First Recommendation**     "Develop procedures to systematically notify all active service CMAS contractors and other service contractors in writing of the State's requirement to protect Personal Confidential Information and Personal Health Information data from unauthorized use and disclosure."

**Response** The audited contracts were from the 2006/2007 fiscal year. During that time period OHC was using a HIPAA Business Agreement with most, but not all, of its service contracts. This agreement clearly states the requirements regarding Protected Health Information and the responsibility of the contractor. However, all active consultants attended the appropriate live Privacy Training provided by the department and took the intranet Privacy training provided by the department.

OHC put in place procedures at the beginning of fiscal year 2007/2008 to ensure that all Requests for Offer for CMAS contracts for services include language regarding the protection of Personal Confidential Information and Protected Health Information data and contain a HIPAA Business Agreement. In addition, all consultants are required to complete training on Privacy and Security within thirty days of the start of the contract.

**Second Recommendation** "OHC should determine if there is a conflict of interest with all CMAS vendors."

**Response** A questionnaire is under development to be given to each consultant before award to determine that there is no conflict of interest as defined in the CMAS services guide provided by the Department of General Services. All current contractors will be required to respond to this questionnaire as well.

These actions should adequately address Finding 3 of the audit. If any further action is required, please contact Adrienne Snyder, OHC Administrative Operations Unit Chief, at (916) 552-9066.

**AUDITOR'S COMMENTS**

## **AUDITOR'S RESPONSE**

Internal Audits is pleased with the efforts made by the Contract Management Unit (CMU). We understand that some of the problems identified by the audit are not within the direct control of CMU, and we acknowledge their willingness to work with other programs to implement our recommendations. We believe that CMU is responsible for the procedures they are recommending, such as the issuance of bulletins and revisions to manuals. The procedures planned in CMU's response should help reduce the problems identified in our audit.